HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT

MALDIVES

Developing a Legal, Policy and Operational Framework for the Sovereign Development Fund

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Fiscal Affairs Department

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The *High-Level Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.

ABSTRACT: In their effort to strengthen fiscal management, the authorities in the Maldives are aiming to develop a legal framework for the country's Sovereign Development Fund (SDF) to provide it a firm legal basis and establish its governance, accountability, and reporting arrangements. An IMF team supported the authorities in this endeavor with advice on key design choices involving the SDF's objectives, operational policies, and interaction with the country's broader fiscal management framework. This note summarizes the mission's analysis and recommendations.

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Background

At the request of the Ministry of Finance (MoF), Government of Maldives, an IMF team undertook a capacity development mission to Male from February 12–19, 2023, to support the authorities in their effort to develop a legislative framework for the Maldives' Sovereign Development Fund (SDF). The mission advised on key design choices for the SDF's legal framework, clarifying its objectives and interaction with the broader fiscal management framework.

The SDF was established in 2017 under a Presidential decree as a fund to finance the repayment of large external debts. Maintained at the Maldives Monetary Authority (MMA), the SDF has been funded by earmarking a portion of the airport development fees (ADF) collected in USD from arriving tourists. Pursuant to a December 2019 Conversion Agreement between the MoF and the MMA, almost the entire SDF balance was converted into MVR, with an understanding that the MMA would provide to the MoF the foreign currency required to pay off external debt at the time of its redemption. While establishing a legal framework for the SDF, the MoF authorities are exploring opportunities for widening the scope of the Fund. There is interest in setting saving and stabilization objectives that would aid intergenerational equity and help moderate the impact of macroeconomic volatility.

Summary of Findings

Until the fiscal situation in Maldives improves, the SDF could continue to usefully serve the twin objectives of external debt repayment and credit enhancement. It has helped boost investor confidence, enabling Maldives continued access to international financial markets, and come in handy for liquidity management during the pandemic. A saving and/or stabilization objective for the SDF would, however, seem aspirational under the current high levels of deficit and debt. Decisions on saving at this juncture should consider the opportunity cost and marginal benefits from debt/deficit reduction and/or growth-enhancing expenditure. Likewise, persistent high deficits would render the stabilization objective infeasible. Once the fiscal situation improves, and credit enhancement no longer needed, the SDF could usefully transition into a Future Generation Fund (FGF) that serves both saving and stabilization objectives. A developmental objective for the SDF must be avoided, as it runs the risk of splitting the budget and creating an extra-budgetary mechanism for funding infrastructure projects.

Decisions are required on the size of the SDF, the treatment of any excess inflows, and the application of the Fund's balance upon its liquidation. While the fund size of a sinking fund would correspond to the underlying debt, a credit enhancement objective would consider a combination of factors, such as market conditions, credit standing, liabilities covered by the fund, and the medium-term debt strategy. Generally, it would be expected to be lower than the size of a sinking fund. If in future the SDF transitions into an FGF, the SDF's balance could be used to capitalize the FGF.

Inflows, outflows, and investments of the SDF must be fully consistent with its objectives. The law could earmark the ADF, in entirety or part, for crediting to the SDF, possibly complemented by other distinctly identifiable specific sources of revenues that can be linked to SDF's objective. Outflows should be restricted to purposes that would support the implementation of the debt management strategy. These would typically include reducing and/or servicing debt and facilitating liability management operations. The law should require channelling all outflows from the SDF through the budget, and the Public Bank Account, and specify the operational mechanism to achieve this requirement. The law should appropriately reflect the investment objectives and provide more granular requirements for managing investments in the regulations.

A strong governance framework would enhance the legitimacy, performance, and accountability of the Fund. The law should establish the State's ownership of the Fund's resources, clarify the authority of the Ministry of Finance (MoF) and the custodian responsibilities of the Maldives Monetary Authority (MMA). It could also require and specify the governance arrangements and clarify accountability for the management of the Fund.

The SDF law needs to be consistent with the Constitution and the broader fiscal management legal framework as enshrined in the Public Finance Act (PFA) and the Fiscal Responsibility Act (FRA). The implications of the Art 250(b) of the Constitution—requiring a special Parliamentary majority for utilizing any reserves within the State Treasury—on the SDF law need to be understood for its implications on the design of the SDF's outflow rules. Likewise, Chapter 11 of the FRA—addressing a fiscal reserve—may present important implications on the SDF's objectives. Further, the Santiago Principles – internationally recognized generally accepted principles and practices for sovereign wealth funds - could provide useful guidance in ensuring the credibility and robustness of the law.

Summary of Recommendations

The mission's key recommendations included:

Enact the legal and regulatory framework for the SDF to operate as a credit enhancement fund (CEF), with provisions for its dissolution (or conversion) in the future. Require that all future inflows to the SDF are maintained in foreign currency (FX) and invested in foreign securities that prioritize liquidity and capital preservation. Ringfence the SDF so that it cannot be used for financing the current account deficit (in normal times) and repayment of domestic debt. Establish a ceiling for the size of the SDF, based on a pre-established liability/asset coverage ratio. If an 'escape clause' is included in the SDF, so that the MMA can borrow FX from the SDF in an emergency, include a time bound reconstitutions requirement where MMA must repay the SDF within a specified period. Exclude all future SDF FX holdings from the MMA's balance sheet or calculation of gross (and net) usable FX reserves.

Enshrine in the SDF law clear inflow and outflow rules consistent with the fund's objective(s). Until the fiscal situation improves, limit the source of inflows to the fund to the ADF, in entirety or a part thereof, other specific clearly identifiable revenue sources, such as, dividends and guarantee fees, and long-term 'windfall' revenues, such as, land lease payments and privatization proceeds, in entirety or a part thereof. Permit outflows from the SDF only for reducing external debt or servicing such debt, facilitating liability management operations, and under exceptional circumstances financing the budget deficit or a part of it. Specify in the law the "exceptional circumstances" under which SDF withdrawals could be permitted for financing budget deficit and the authority and process for its approval.

Include in the law a requirement to prepare and publish an investment policy. Details of the policy—its objectives, contents, term—could be defined in regulations. Consistent with the objectives of a CEF/SSF, invest in FX instruments that match the loan portfolio. If the SDF accepts inflows of a long-term nature (such as land lease payments), invest these assets in long-term, foreign currency instruments.

Set in the law the SDF's governance structure and accountability arrangements. The governance structure could potentially comprise a high-level governing council, an investment committee, fund administrator, custodian, and external and internal auditors. Accountability arrangements should include the reporting requirements conforming to international standards, external audit by an independent external auditor, preferably the AG, the submission to Parliament and publication of financial statements and audit reports, and internal auditing standards.

Adopt a sequenced approach to developing the SDF and its legal framework, allowing time for the SDF—and the MoF's capacity to manage it—to evolve. The law may focus initially on the immediate objectives associated with a CEF. A formal legal opinion from the Attorney General may be obtained to address whether the SDF falls within the ambit of Art. 250(b) of the Constitution. During the drafting of the law, other relevant laws, regulations, and draft legislation should be reviewed to ensure overall consistency and provisions should be built for a reasonable transition to ensure readiness for compliance.